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February 29, 2000

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BY HAND

Honorable Vernon A. Williams
Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582
1925 K Street, N.W.
Washington D.C. 20423-0001

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Office of the Secretary

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Public Record

Re: Public Views on Major Rail Consolidations, STB Ex Parte No. 582

Dear Secretary Williams:

On behalf of our clients, Montana Rail Link, LLC ("MRL") and I&M Rail Link, LLC ("IMRL"), we hereby submit to the Surface Transportation Board MRL and IMRL's written comments in the above-referenced proceeding. Enclosed are 10 copies of this filing and a 3.5-inch disk containing this letter formatted in Word Perfect.

Please acknowledge receipt of this letter by date-stamping the enclosed acknowledgment copy and returning it to our messenger.

Very truly yours,

Jo A. DeRoche

Jo A. DeRoche

cc: J. Fred Simpson (by facsimile)

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

**WRITTEN STATEMENT
OF MONTANA RAIL LINK, INC.
AND I&M RAIL LINK, LLC**

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The Surface Transportation Board (the "Board") has determined that public hearings are appropriate to discuss the views of interested parties regarding the trend of major rail consolidations occurring in North America. Montana Rail Link, Inc. ("MRL") and I&M Rail Link, LLC ("I&M") will jointly participate in these public hearings on March 8, 2000. Pursuant to the Board's decision served January 24, 2000, MRL and I&M submit this written statement addressing important concerns that the Board should consider prior to approving any future major rail consolidations.

MRL and IMRL are affiliates, each of which is a regional class II railroad. Together these two carriers operate over more than 2,200 miles of rail line in nine states. MRL purchased and leased its rail properties from Burlington Northern Railroad Company in 1987. It currently operates over more than 900 route miles via a combination of owned lines, leased lines and trackage rights. MRL's rail operations extend from Spokane, Washington to east of Billings, Montana, and serve more than 100 stations throughout Montana, Idaho and Washington. MRL is a high density railroad, handling over 200,000 carloads, and its main line track is maintained to accommodate trains operating at speeds of 60 miles per hour. Accordingly, MRL provides an

important corridor for rail access between Central and Southern states, on the one hand, and the Pacific Northwest and Canada, on the other hand.

I&M acquired its system from Soo Line Railroad Company in 1997. It owns over 1,100 miles of rail line located in Iowa, Illinois, Minnesota, Missouri, Wisconsin and Kansas, and has trackage rights over approximately 262 additional miles of line. I&M's rail system provides a strategic link to four major cities: Minneapolis, St. Paul, Chicago and Kansas City. In addition, I&M, which connects with all railroads in Chicago, offers intermodal service between Chicago, Davenport, Kansas City and the Twin Cities. I&M serves both agricultural and industrial customers and has an equipment fleet of approximately 2,300 rail cars and 115 locomotives. I&M provides important rail access and rail alternatives to shippers located throughout the Midwest.

MRL and I&M are controlled by Dennis Washington, who also controls Southern Railway of British Columbia. All three railroads operate as separate, independent railroads.

COMMENTS:

Short line and regional railroads (the small railroads) operate 29 percent of the total US track miles. Much of this mileage makes up the nation's rural gathering network, for over 20 percent of the traffic. It is MRL and I&M's position that a substantial portion of that gathering network is now at risk. The problems of small railroads are partially due to public funding decisions and partially due to the consolidation that has occurred in the railroad industry over the past 20 years. Congress and the states must address the public funding issues, but issues relating to industry consolidation are clearly within the purview of the Board. In general, MRL and I&M do not oppose railroad mergers. Rather, MRL and I&M appear in this proceeding to ask the

Board to carefully consider imposing conditions in any future mergers to protect and preserve the affected small railroads.

At the start of the twentieth century, before locks and dams on the major rivers, interstate highway systems and air freight, railroads had sprung up all over the country. They had no competition but from each other. There were so many carriers that they managed to prove that too much competition can be a bad thing, and many railroads failed for lack of sufficient traffic.

By the 1970's, the railroad industry in this country was a shambles. Six eastern railroads were in bankruptcy, and Congress passed the Regional Rail Reorganization Act of 1973 and the Railroad Revitalization and Regulatory Reform Act of 1976 to address the crisis. In the midwest, major railroads were also failing. The Rock Island and the Milwaukee Road, filed for bankruptcy in the 1970's. The Staggers Rail Act of 1980 ("Staggers") was passed to give railroads tools needed to compete with other modes. A general consensus had developed that the public interest could no longer be served by requiring numerous railroads to compete in any particular corridor and that the entire system of privately-owned lines was likely to collapse unless railroads were allowed to consolidate and to shed light-density lines. Public policy shifted from emphasizing competition among railroads to encouraging consolidation.

Among the Staggers changes was the means for railroads to sell redundant or marginal lines to new, noncarrier entities who were able to keep the traffic on those lines and within the railroad system by serving the shippers in more efficient, cost-effective ways than the class I's had been able to do. These sales enabled the class I's to focus on improving their core routes. Today, we have four strong, well-maintained trunk line railroads in this country. We also have several hundred short lines that have been spun off from the consolidating trunk line systems.

The short lines provide a gathering network of light density lines serving rural America. MRL and I&M are post-Staggers railroads, created by class I line sales.

As described in the White Papers of the STB Small Railroad Shipper Advisory Council, a divergence of interests has now developed between the trunk line systems, which have achieved a robust financial strength, and many of the light density short lines, which for various reasons find themselves at risk of financial failure. Small railroads depend on ready access to the national network, competitive rates and adequate car supply. Trunk lines, upon which the short lines were intended to be dependent, do not necessarily see it to be in the trunk line's interest to continue soliciting freight via the short lines. Significant public policy issues need to be addressed with regard to whether or not the rural gathering network of short line and regional railroads should be preserved and if so, what the role of the Surface Transportation Board should be.

The rule of thumb in the railroad industry has been that the further you can handle a car without switching it, the more profitable the operation will be. Stated another way, railroads make money handling traffic between terminals and spend money at terminals. Railroads, therefore, have always focused their efforts on obtaining the longest line haul possible, in order to improve their profits. The benefits of mergers between carriers that have parallel routes are produced by consolidating redundant facilities and improving manpower utilization. On the other hand, the benefits of end-to-end mergers result from the opportunities to extend the length of the line-haul between switching/interchange, or better yet, to eliminate the need for interchange entirely – “seamless” service.

For purposes of these comments, I&M and MRL accept that seamless service produces certain efficiencies that cannot otherwise be achieved. We accept that when two 1,000-mile line

railroads merge and can now handle a car 2,000 miles, the merged carrier will be able to provide a more efficient, cost-effective move for that distance than could have been provided by two separate, smaller railroads. The problem from the small railroad perspective is that not all traffic needs to move 2,000 miles, and almost by definition, traffic originating or terminating on a short line railroad seldom moves in single line service. Small railroads interline almost all of their traffic. Unfortunately, the merged carrier is focusing on the 2,000-mile move, because that is where it expects to obtain the benefits it told the Board it would realize from the merger. Given that railroads, like all businesses, must pick and choose where to deploy capital and managerial energy, the focus on long-haul, single-line traffic produces a concomitant reduction in resources dedicated to shorter haul, interline moves. The 1,000-mile move becomes only half as important to the merged carrier as it was when it was the long-haul move for one of the pre-merger railroads. Similarly, the interline moves with the connecting small railroads become less attractive. Merged trunk lines find that they can fill their systems with traffic originated or terminated on their own line and are incented to price against traffic requiring interchange with connecting small railroads.

Thus, there exists a real tension between the desire of the four trunk line carriers to achieve the efficiencies of long-haul, single-line service and the need of small railroads and their customers to do business on an interline basis. Because of the disparity in size that has resulted from the trunk line consolidation, small railroads are often unable to effectively challenge or bargain with their trunk line connection. It is interesting to note that the Union Pacific argued that the merger of Burlington Northern with The Atchison Topeka & Santa Fe Railway left Union Pacific unable to compete unless it were merged with Southern Pacific. The plight of the small railroads is obviously much more extreme.

In any merger proceeding, the Board is authorized to condition its approval on any conditions that the Board deems appropriate to encourage competition and further the National Transportation Policy. The merging parties are free to accept the conditions and proceed or refuse the conditions and abandon the proposed merger. As mergers are no longer required to preserve the financial viability of a privately-owned trunk line system, MRL and IMRL urge that, in future merger proceedings, the Board look closely at the following issues and types of conditions:

1. Will the consolidation enable the merging carriers to price transportation services in a way that will favor shippers on their own stations to the detriment of shippers located on small railroad connections? In making this assessment, the Board should look closely at pricing policies of the merging entities. Will the merging carriers make pricing available to traffic that originates or terminates a small railroad (when the efficiencies such as car cycle time can be provided by the small railroad) that is similar to the rate structure that will be offered to shippers located at nearby points on the trunk line? The Board should carefully review the magnitude of this pricing power, and its effect on small railroad connections, shippers and communities. In appropriate situations, the Board should impose conditions that address unwarranted rate discrimination that will adversely affect small railroads and their customers.

2. Do the merging carriers have “rate blocks” in place – *i.e.*, contractual arrangements with connecting small railroads -- that effectively preclude the small railroad from interchanging traffic with other railroads. If so, the Board should condition approval of the merger on voluntary elimination of the blocks so as to preserve rail options for customers located at stations on the small railroad.

3. Does either of the applicants have exclusive pricing authority for traffic handled on an interline basis with one or more short lines? If so, the Board should condition approval of the merger on voluntary waiver by the merging railroads of their control of short line pricing authority. Further, if the merger causes a material diminution of interline traffic with a small railroad, the merged carrier should be required to participate in interline moves identified by the small railroads, with the compensation to the merged carrier being determined on a formula-driven basis.

4. Do the merging carriers plan to realize benefits through a disproportionate allocation of capital to the “seamless” routes, to the detriment of the small railroad connections and the shippers? In such cases, the Board should consider conditions requiring the merged carrier to commit a certain minimum volume of business to the small railroad connections.

5. Do the merging carriers have the contractual right to supply exclusively the equipment for their small railroad originations, thereby compounding the dependence the short lines and their shippers have on the class I?

6. Recent history has shown us that railroad mergers do not occur easily. Communications systems do not communicate as anticipated; facilities become congested; and force reductions eliminate the people who might have solved the problems. Everybody suffers when the merged carrier not only fails to realize the efficient state it described to the Board but fails to even provide the level of service provided by the separate carriers prior to the merger.

When service failures occur, short line railroads and their shippers suffer, through no fault of their own. Traffic congestion on the merged entity reduces the short line’s revenue opportunities. Short line-owned equipment is delayed in the congestion; class I-owned equipment is delayed in the congestion; and subsequent revenue moves are lost for lack of

equipment to load. Shippers become impatient with the delays and divert their goods to other modes of transportation.

CONCLUSION

For the reasons stated above, the Board should carefully scrutinize all future merger applications that come before it to assure that the benefits to be gained from a larger system do not come at the expense of the short line railroads and their shippers.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "J. Fred Simpson", is written over a horizontal line.

J. Fred Simpson
Executive Vice President
Washington Transportation Group

Dated: February 29, 2000

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